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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1945

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No. 436

M. M. ARGO,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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STATUTE

Internal Revenue Code, Section 3772 (d) 4,21,38

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1945

No. 436

M. M. ARGO,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

MAY IT PLEASE THE COURT:

The petition of M. M. Argo respectfully shows to this Honorable Court:

Summary Statement of the Matter Involved

The controversy involves petitioner's federal income tax liability for the years 1938, 1939, and 1940. Petitions for review of two decisions of the Tax Court of the United States (one involving the years 1938 and 1939, and one involving the year 1940) were consolidated for hearing in the Circuit Court of Appeals. (Tr. p. 104)

Birmingham Electric & Manufacturing Company, an Alabama corporation, all of the capital stock of which was owned by the petitioner, was dissolved on December 31, 1936. Petitioner thereupon entered into an oral agreement of partnership with his wife and his three minor children, whereby each of them became a partner owning a one-fifth interest in a partnership which was to carry on the business formerly conducted by the corporation. During 1937 and during the tax years here involved—1938, 1939, and 1940—Birmingham Electric & Manufacturing Company (sometimes hereinafter referred to as the "company"), which was formed pursuant to this partnership agreement, engaged in the business of rebuilding and repairing electrical equipment and of selling such equipment. (Tr. pp. 50-51)

The Collector of Internal Revenue for the District of Alabama assessed against the petitioner a deficiency of $876.14 for the year 1937 on the ground that no bona fide partnership existed and that petitioner was subject to income tax on the entire net income of the company. After paying the assessment, the petitioner sued the Collector in the United States District Court for the Northern District of Alabama to recover the amount thus paid. The case, which was entitled *Argo* v. *Willingham, Collector of Internal Revenue,* was tried by the Court and a jury. It was stipulated by the parties at the trial that, if the jury found that there was a bona fide partnership between the petitioner, his wife, and three children during the calendar year 1937, the issues should be adjudged in favor of the petitioner. The jury found that such a partnership existed during the year 1937 and the Court thereupon, on October 16, 1942, entered judgment for the petitioner. The Collector appealed to the Circuit Court of Appeals, but later dismissed his appeal. (Tr. pp. 94, 141-152)

For the years here involved (1938, 1939, and 1940), the Commissioner again taxed the petitioner on the entire income from the partnership, asserting the same ground as the basis for his action. The petitioner appealed to the United States Board of Tax Appeals (which thereafter became the Tax Court of the United States). The petition for review as to tax liability for the years 1938 and 1939 was filed with the Board of Tax Appeals on February 21, 1942; the petition as to liability for the year 1940 was filed on August 24, 1942. The petitioner made the same contentions in the Tax Court that he had made in the former case in the District Court and asserted in addition that the judgment of the District Court was *res adjudicata* of and operated as an estoppel against the Commissioner to raise *the same issues and questions* with respect to the years 1938, 1939, and 1940 that had been raised and adjudicated with respect to the year 1937. The pleadings and the Order on Pre-trial Hearing which formulated the issues in accordance with Rule 16 of the Federal Rules of Civil Procedure, and Judgment of the District Court in the former case were introduced in evidence in the Tax Court. (Tr. pp. 141-152)

The evidence before the Tax Court showed without dispute that from the date of its formation on January 1, 1937, until the end of 1940—a period including *the year 1937,* with respect to which the said judgment was rendered in the District Court, and *the years 1938, 1939, 1940,* tax liability for which is here in question—the company continued to operate in the same manner; that the nature of its business—rebuilding and repair of electrical equipment and sale of such equipment—remained the same throughout the years 1937, 1938, 1939, and 1940; that during that period, the petitioner's work and activities in the business remained the same; that the activities of the other partners in the business also remained the same, except

that the activities of three of the other partners—petitioner's wife and his two older children—were greater in 1938, 1939, and 1940 than in 1937; that the number of persons (other than the partners) employed by the company remained approximately the same (from 25 to 30) during those four years; and that the percentage of return on the company's investment was smaller in the years 1938, 1939, and 1940, than in the year 1937.

The Tax Court recognized the effect of the former judgment, saying in its opinion:

> "* * * the verdict of the jury and the judgment entered thereon involved a determination that there was a partnership for Federal income tax purposes in 1937. The question presented here in docket No. 112248 is the same except for different years, such question requiring a determination of whether there was a partnership for Federal Income tax purposes between the same persons in the same business during the year 1940" (R. p. 86).

The Tax Court held, nevertheless, as to the years 1938 and 1939, that the parties were not the same or in privity, and that accordingly the principle of *res adjudicata* or estoppel by judgment was not applicable; and, as to the year 1940 (the parties being the same or in privity by virtue of section 3772(d) of the Internal Revenue Code), that the principle was inapplicable, because the evidence which was submitted to the jury in the trial in the District Court was not in the record before the Tax Court.

The Tax Court declined to give any weight to the former judgment in its consideration of petitioner's tax liability for the years 1938, 1939 and 1940; and in effect held that, in spite of the decision of the District Court that a partnership for income tax purposes existed throughout the year 1937, the burden remained on petitioner to prove that such a partnership existed in 1938, 1939 and 1940; and

that the facts adjudicated by the former decision—including the formation of a bona fide partnership for income tax purposes on January 1, 1937, and the ownership by each partner of a one-fifth interest in such a partnership throughout the year 1937—were neither conclusively nor presumptively true and that these issues, so far as material in the cases involving the later years, could again be inquired into without reference to the former decision.

The Tax Court held further that, although the evidence before it afforded "no basis for a positive finding that the activities and services of the petitioner were the main factors in the production of the income" of the company, it pointed "quite strongly in that direction"; that the petitioner had failed to show affirmatively that his activities and services were not the main factors in the production of such income; and that, accordingly, the petitioner was taxable upon the entire net income of the partnership.

The Tax Court's conclusion that petitioner failed to show that his activities and services were not the main factors in the production of the company's income was based on two subsidiary findings of fact or statements of fact, which are set forth and stressed in that court's opinion: (1) the statement that the court had not been "informed as to whether other persons were employed" by the company (R. p. 89) and (2) the statement that the annual earnings of the company during the years 1937-1940, inclusive, were "50 per cent and more in excess of the capital investment in physical assets" (R. p. 90). The record shows that the company had an average of from 25 to 30 employees during the years in question (See Respondent's Exhibits H-M, Certified in original form); and that the company's investment consisted not only in the physical assets shown by the balance sheets at the beginning of each year, but in large items of cash expended annually

for labor, material, etc., and that the return on the company's total investment did not exceed 10% in either 1938, 1939, or 1940.

In the judgment review of which is here sought, the Circuit Court of Appeals for the Fifth Circuit affirmed the judgments of the Tax Court.

Questions Presented

(1) Whether and to what extent the judgment of the United States District Court for the Southern Division of the Northern District entered on October 16, 1942, in the case of *Argo* v. *Willingham* constitutes *res adjudicata* or operates as an estoppel by judgment in the suit with respect to petitioner's income tax liability for 1940.

(a) Whether the following issues, which were determined by the former judgment, are material to a determination of the questions raised in the suit involving the year 1940:

> (1) The taxpayer on January 1, 1937, made valid bona fide gifts to members of his family of their several interests in the business.
>
> (2) The taxpayer on January 1, 1937, ceased to be the individual owner of the business and the several partners became the owners thereof.
>
> (3) A partnership valid for income tax purposes was *formed* January 1, 1937, and existed throughout that year.

(b) If the three issues set forth in (a) are material to a determination of the issues in the suit involving the year 1940, whether the respondent is estopped to controvert the former adjudication as to those three issues, regardless of whether the evidence upon which the former adjudication was based appears in the record of the instant case.

(c) Whether the adjudication in *Argo* v. *Willingham* that a partnership valid for income tax purposes existed throughout the year 1937 estops the respondent from asserting that no such partnership existed in 1940, when, according to the undisputed evidence in the instant case, the business was conducted in the same fashion without substantial change of any kind from January 1, 1937, through the year 1940.

(d) Whether the said adjudication operates as *res adjudicata* or as an estoppel by judgment in the circumstances set forth in (c), regardless of whether the evidence upon which the former adjudication was based appears in the record of the instant case.

(2) Whether the partnership determined by the former judgment to have been in existence for income tax purposes during 1937 is presumed, in the absence of proof, to continue to exist and to conduct its operations in the same manner.

(3) Whether the respondent has the burden of proving discontinuance of the partnership existence of which, for income tax purposes, throughout the year 1937 has been determined by the former judgment.

(4) Whether the Circuit Court of Appeals erred in failing to hold that the Tax Court, in its consideration of the case involving the years 1938 and 1939, should have given weight to the former judgment of the District Court.

(5) Whether the Circuit Court of Appeals erred in failing to hold that the partnership was a valid and bona fide partnership for income tax purposes during the years 1938, 1939, and 1940.

(6) Whether the Circuit Court of Appeals erred in holding that the findings of the Tax Court were supported by substantial evidence.

(7) Whether a decision by the Tax Court of the United States which is based upon primary or subsidiary findings of fact contrary to the undisputed evidence is a decision in accordance with law.

Reasons Relied Upon for Allowance of the Writ

The decision rendered in this case by the Circuit Court of Appeals for the Fifth Circuit is in conflict with the decision of the Circuit Court of Appeals for the Sixth Circuit in the case of *Leininger* v. *Commissioner* (1936), 86 Fed. (2d) 791.

With respect to the applicability of the principle of *res adjudicata* or estoppel by judgment in the case involving the year 1940, the Circuit Court of Appeals for the Fifth Circuit has decided an important question of federal law in a way which is not in accord with the applicable decisions of this Court.

Insofar as the decision of the Court below holds that the Tax Court did not err in failing, in its consideration of the case involving the years 1938 and 1939, to give weight to the judgment of the District Court it decides an important question of federal law which has not been but which should be decided by this Court.

Insofar as the decision of the Court below holds that the decision of the Tax Court was supported by substantial evidence, it decides important questions of federal law respecting the validity of partnerships for income tax purposes which have not been but which should be decided by this Court.

Insofar as the decision of the Court below holds that the decision of the Tax Court was supported by substantial evidence, it decides an important question of federal law in a way probably not in accord with the applicable decisions

of this Court. The specific question as to the weight which should be given ultimate findings of fact or inferences of fact by the Tax Court based upon primary or subsidiary findings of fact contrary to the undisputed evidence has not been but should be decided by this Court.

Res adjudicata in tax matters, the validity of family partnerships for income tax purposes, and the question of what constitutes "substantial evidence"—the three principal issues involved in this case—are federal questions of the highest importance. The decisions of this Court relating to those questions do not cover many phases of the two subjects, and it is evident from the decisions of the lower Courts that they have found difficulty in applying the principles enunciated in the decisions of this Court which deal with those questions or with related matters.[1] We urge, therefore, that this Court review the decision of the lower Court in this case and settle the important questions presented by this record.

Wherefore, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court directed to the United States Circuit Court of Appeals for the Fifth Circuit commanding that Court to certify and to send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket, No. 11,276, *M. M. Argo, Petitioner,* v. *Commissioner of Internal Revenue, Respondent,* and that the said judgment of the United States Circuit Court of Appeals for the Fifth Circuit may be reversed by this Honorable Court, and that your peti-

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[1] See the article by Robert J. Bird on *Res Judicata* in the August, 1945, issue of the magazine, *Taxes*

tioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

Respectfully submitted,

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